No. 10551

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

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J. B. CLOVER,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REHEARING.

GEORGE G. WITTER,
1027 Citizens National Bank Building, Los Angeles 13,
Attorney for Petitioner.

Parker & Company, Law Printers, Los Angeles. Phone TR. 5206.

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In rendering its decision in this case this Honorable Court has clearly and frankly stated (1) that it feels bound, particularly under the *Dobson* case, by the Findings of Fact made by the Board, and (2) that such findings, in its opinion, support the judgment.

With the first proposition we have no quarrel, provided it be understood that by "findings" is meant only those findings that are contained in the Findings of Fact and not mere recitals contained in the opinion. To the second proposition we take exception and believe on the basis of that exception together with other grounds offered below, that we are entitled to a rehearing. We offer the following grounds as a basis for this petition:

First: Facts found in the Findings of Fact alone do not support the judgment. Resort has been taken to statements recited in the *opinion* to sustain the judgment.

Second: The Findings of Fact made by the Court below contradict each other and contradict what both parties to the action agree are the facts. They are both inadequate and defective.

Third: If the right of appeal be regarded as a separate property, as the Tax Court has done, then the dissenting opinion is correct in stating that the right of appeal arose out of the land and when disposed of for cash constituted payment for the land.

Fourth: Taxpayer made disposition of his water rights for the first time when he assigned his judgment and dismissed his appeal and those acts constituted the disposition of his property.

I.

Facts Found in the Findings of Fact Alone Do Not Support the Judgment. Resort Has Been Taken to Statements Recited in the Opinion to Sustain the Judgment.

Viewing the Findings of Fact in the light most favorable to the Government, they go only to the extent of finding "On the same date and in form as a separate transaction taxpayer received from Nev-Cal $41,000 'as consideration for the dismissal of appeal and waiver of right to appeal by him.' "

In its legal opinion the Tax Court goes much further. It makes additional statements—statements not legal in character, nor mere reasoning based upon its Findings of

Fact, but clearly and plainly statements of additional alleged facts. Examination will disclose that the judgment of the Court below, as well as of this Honorable Court, was based upon these additional statements recited in the opinion and could not have been arrived at on the basis of the findings made in the Findings of Fact alone.

Let us consider whether the Findings of Fact proper support the judgment. The extent of the findings has been stated above. The question is: Must a bare dismissal of appeal for a consideration be regarded as resulting in ordinary income? Dismissal of appeal or dismissal of suit is a very common method employed to effect settlement of litigation over property rights and this is so in cases where the payment made is without question intended and accepted by the parties as compensation for the property rights themselves. Such practice is a matter of common knowledge to both courts and attorneys. But the Tax Court says (not in its Findings of Fact but in its legal opinion): "It (the $41,000) was received as consideration for the taxpayer's forbearance to exercise his legal right of appeal, hence was not capital gain but ordinary income." Taken by itself, or based upon the findings proper, we challenge the soundness of any such conclusion. Significantly, the Court cites no cases and offers no authorities to support that proposition. Forbearance to exercise a legal right where settlement has been effected means nothing except as related to the subject matter of the action and the intention of the parties. One or two common examples will serve: A person, through reckless driving of his automobile or airplane, demolishes my building. I threaten to bring suit. The driver offers to pay me what both of us regard as the

reasonable value of the building in consideration of my agreement not to bring suit. I accept. I have foregone my legal rights to sue but plainly what I receive is compensation for my buildings and not ordinary income. There is no technicality or mystery involved in this. It follows the usual rule of being determined by the intention of the parties. Again, suppose I have a dispute with a neighbor over land, I bring suit and he recovers judgment below. I appeal. After the period for taking the appeal has expired and on the eve of hearing, he offers a sum which we both regard as satisfactory compensation for my disputed rights in the land in consideration of my agreement to dismiss the appeal. I accept the offer and dismiss the appeal. Again I have foregone my legal rights in the Court but can there be any question that the money received was received for my rights in the land? Certainly as much so as if the asset itself had been sold. It plainly does not follow as a general proposition that forbearance to exercise a legal right results in ordinary income. Forbearance to exercise a legal right means nothing except as it be related to the subject matter and the intention of the parties. In fact, much more often than not money received in settlement of litigation is received for the property rights involved. It would be only in a case with extraordinary circumstances and unusual attendant facts that a substantial amount would be received for foregoing an empty legal right and not be intended as compensation for the property right relinquished or destroyed. Now the Findings of Fact proper recite only the bare dismissal of the appeal for a consideration. It is on that finding alone that the judgment must stand or fall. It is only in the opinion that there is any hint that it

was paid to avoid delay. It is only in the opinion that any unusual circumstances are found that might be held to take the case out of the ordinary category and characterize the payment as other than for land. The Tax Court obviously felt the need of such additional facts. This Honorable Court also felt the need for such additional facts taken from the opinion for it recites them at length. (Paragraph 5 of the Opinion.) The Court below makes no findings as to the intention of the parties. It does not find that the appeal was frivolous or brought for nuisance value. It does not find that the sum was paid merely to avoid delay. It finds at the most that the petitioner dismissed his appeal for $41,000 paid by Nev-Cal. The mere fact that Nev-Cal paid the money cannot be regarded as a controlling circumstance for two reasons, first, Nev-Cal was in privity with the city. Second, it is immaterial from whom payment was received or the reason that prompted it so long as the taxpayer accepted it as payment for his water rights.

There is "a clear-cut mistake of law" if the Findings of Fact are inadequate to support the judgment. To hold otherwise would mean to say that a conclusion without findings of fact should be sustained because not in conflict with any findings made. Even in the *Dobson* case the Supreme Court said that the judgment must have "warrant in the record." One of the assignments of error relied upon by this petitioner was that the Findings of Fact do not support the Judgment. Since the unusual facts, found in the opinion only, are necessary even under the Court's theory to characterize the payment as ordinary income, the judgment should be reversed.

II.

The Findings of Fact Made by the Court Below Contradict Each Other and Contradict What Both Parties to the Action Agree are the Facts. They Are Both Inadequate and Defective.

What we have to say here, although set apart, might well be added to what has been stated under Heading No. I above. The majority opinion of this Honorable Court states that "The Court on the evidence before it found that these forms accurately reflect the real substance of the arrangement." We do not find any such statement in the Findings of Fact made by the Court below. The Findings of Fact merely recite that the parties did certain things and then incorporate in quotations portions of the forms employed in explaining the consideration for such act. It is, therefore, not entirely clear whether the Court below meant to find that the parties actually did certain acts for certain consideration or that the parties did certain acts for which they employed certain forms which are quoted. But, assuming that the Board did intend to find that the forms used by the parties represented the substance of the transaction, let us analyze those forms to ascertain whether they clearly reflect what was done. The first finding is that, "On May 28, 1933, *while the appeal was pending* the taxpayer '*sold* and *assigned* all his right, title and interest in the $20,000 award' to Nev-Cal Company, *stipulating and agreeing that the assignee might prosecute any appeal* or other proceeding in its own name." Now certainly this was a clear disposition of the right of appeal by this appellant. He not only assigned his right, title and interest in the award below, which was sufficient to constitute the assignee the real party in interest,

but expressly stipulated that the assignee should have the rights in the appeal. This assignment was made "for and in consideration of the sum of $20,000 to him in hand paid by Nev-Cal."

The next finding is clearly conflicting and is in words as follows: "On the same date and in form as a separate transaction, taxpayer received from Nev-Cal $41,000 'as consideration for the dismissal of appeal and waiver of right to appeal' by him." (Quere: What right did taxpayer have to dismiss after having sold and assigned his right to appeal?)

The next finding made is in words as follows:

> "The taxpayer filed a dismissal of the appeal and also a release and discharge of the city from all liability growing out of the condemnation of his interest 'for and in consideration of the payment into Court of $20,000 in satisfaction of judgment,' together with certain costs 'and in consideration of the payment to (him) of an additional sum of $12,000 by the city."

In those findings we have three separate statements of consideration received by the taxpayer for the disposition of his rights in his appeal, all different in language and amount. Moreover, the total recited in the findings does not agree with the total both parties to this action agree petitioner received. Further, the findings are in conflict as to who paid the money, and nowhere is there a finding that the petitioner received $20,000 for his littoral rights separate from his appeal.

The trouble is that the Court below tried to follow the forms filed by the parties and as so often happens the forms are conflicting, with the result that the findings are

also conflicting and confused, inadequate, and even out of line with what both parties agree are the facts. In the following forms the Court failed to find the substance. The case of *Gray v. Powell,* 314 U. S. 402, cited by the Tax Court in support of its following forms, has no true application to the instant case. In *Gray v. Powell* a corporation had chosen to operate through several subsidiaries. When it afterward appeared disadvantageous to have done so it asked that such subsidiaries be disregarded. Hence the Court's statement that parties cannot put aside a deliberately chosen arrangement.

If the taxpayer's case on appeal is to be concluded solely on the Findings of Fact made by the Tax Court, then certainly the law, including the *Dobson* case, intends that such findings shall be clear and complete in support of the judgment. Particularly does the taxpayer have a right to expect such clear and unequivocal findings where the whole case turns upon a supposed or alleged finding of fact made by the Court below and the Circuit Court feels itself bound by such finding. That is truly the situation in the instant case and the majority opinion so states. Consider also that in the instant case the lower Court has arrived at a conclusion which is not in line with ordinary thinking and for that very reason should have stated with even more particularity than usual the peculiar facts on which such conclusion is based. Again, the cardinal principle in tax cases that substance shall prevail over form impresses upon the Tax Court in the instant case a special duty to support its judgment with clear and unequivocal findings. Again, and perhaps most important

of all, consider that the 90-day letter of the Commissioner characterizes the entire $61,000 as "capital net gain." [See Tr. p. 11.] In view of the statutory presumption of correctness which such letter enjoys in the Tax Court, was it not incumbent on the Tax Court to find its distinguishing facts with particularity? All this the Court below has failed to do. Its findings are both inadequate and defective.

III.

If the Right of Appeal be Regarded as a Separate Property, as the Tax Court Has Done, Then the Dissenting Opinion Is Correct in Stating That the Right of Appeal Arose Out of the Land and When Disposed of for Cash Constituted Payment for the Land.

The taxpayer acquired certain littoral rights in 1918. In 1934 as a result of condemnation proceedings these littoral rights were taken away from him. Such a proceeding constitutes a sale or exchange under the Revenue Acts. *Hawaiian Gas Products, Ltd. v. Commissioner,* 126 F. (2d) 4. In exchange for such littoral rights he received two things: First, an award of $20,000; Second, a right of appeal. The right of appeal was received in exchange for the littoral rights—as much so as the award itself. As was said in the dissenting opinion, it cannot be treated "as if it came out of thin air." Without such littoral rights and without their being taken from him, how could the petitioner have become vested with such right of appeal? The right of appeal was a direct and proximate result of his investment in littoral rights and the taking

from him of such littoral rights. The right of appeal had only a speculative value when received. It could not be said to have a determinable fair market value when received. It, therefore, comes within that group of cases holding that where property is exchanged for other property and the latter does not have a fair market value then the taxable incident is deferred until the latter property is converted into money or other property having a measurable market value and when so converted the cash or other property received constitutes payment for the original asset and is applied against the cost basis of the original asset.

Below is a partial list of the decided cases wherein it has been held that the notes, contract, or other property received in exchange had no determinable fair market value when received and would become income only when converted into cash or other property in an amount in excess of the cost of the original asset.

Cambria Development Co., 34 B. T. A. 1155;
Ravlin Corporation, 19 B. T. A. 1112;
Miami Beach Improvement Co., 14 B. T. A. 10;
Stevenson, 9 B. T. A. 552;
Joilet Norfolk Farm Corporation, 8 B. T. A. 824;
Titus, Inc., 33 B. T. A. 928;
Old Farmers Oil Co., 12 B. T. A. 203;
Woodman Realty Co., 17 B. T. A. 886;
Burnet v. Logan, 283 U. S. 404;
E. F. Simms, 28 B. T. A. 988;
Rocky Mt. Development Co., 38 B. T. A. 1303;

Hunt Production Co., 38 B. T. A. 457;

Kimball, et al., 41 B. T. A. 940;

Commissioner v. Edwards Drilling Co., 95 F. (2d) 719 (C. C. A. 5);

Dearing, et al., 36 B. T. A. 843.

The leading case in this group of cases is the decision by the Supreme Court in *Burnet v. Logan, et al.*, 283 U. S. 404. The case is authority for the proposition that where a property is exchanged for other property and the latter does not have an ascertainable or market value, then the taxpayer does not realize income until the latter property is converted into cash or other property having a determinable market value, and no income is realized until the cost of the original property given in exchange has been recovered.

Under the holdings in the above decision it is immaterial whether the taxpayer files his return on a cash or an accrual basis. The asset without determinable fair market value is income to neither until converted into something having measurable market value. See:

Titus, Inc., 33 B. T. A. 928.

The judgment in the instant case providing payment of a certain amount for the condemned rights is like the contracts discussed in the foregoing cases, which contracts also provide for payments of certain amounts for the property taken or sold. The pending appeal, since it operated solely on the judgment, was also like the contracts dealt with in the above cited cases. Some of those contracts were evidenced by notes, others were not; some were secured and others unsecured. All represent the payment

the owner is to receive for his property. Like the contracts discussed, the judgment which had not become final and the appeal pending therefrom did not have determinable market value. When finally liquidated they constituted payment for the property taken and to the extent they exceeded the cost represented gain. Since the property taken was admittedly a capital asset the gain realized was wholly capital gain. Since the asset taken was admittedly acquired in 1918 only 30% of such gain was subject to tax.

IV.

Taxpayer Made Disposition of His Water Rights for the First Time When He Assigned His Judgment and Dismissed His Appeal and Those Acts Constituted the Disposition of His Property.

I wish to renew the argument advanced in the Appellant's Opening Brief. I offer the following in support of that argument because it presents what is perhaps a fresh viewpoint.

The taxpayer did not lose his water rights in 1934 when the judgment was entered. So long as judgment was not final the taxpayer remained the owner of his water rights, subject, however, to the judgment of condemnation already entered and his pending appeal therefrom. The water rights, the judgment entered, and the pending appeal were all part and parcel of the same property. The judgment and pending appeal during the period 1934 to May, 1935, constituted a lien on his property, a restriction, limitation, and encumbrance to his title. They were not separate and distinct properties but rather legal incidents in the same property. When the petitioner as-

signed the judgment and dismissed his appeal he made disposition for the first time of this property, that is, of his water rights with all the incidents thereto. The assignment and dismissal constituted his disposition of his water rights without awaiting final court action. Nothing further was required to sever his ownership but severance did not occur until that time. Dismissal of the appeal was nothing more than the disposition of one of the incidents in the property itself—a step taken in disposing of the water rights themselves.

Procedural laws of the land are as much a part of the bundle of rights that comprise property as are substantive laws of the land. This is so, otherwise a property owner would have no means of enforcing his substantive rights to protect his property. The Constitutional guaranty that property shall not be taken without due process of law is one of the rights acquired with property. The laws of the land are a part of his contract. The right to trial if a city should ever seek to condemn the lands of this petitioner, and the right to appeal if he were aggrieved by such trial were rights that this petitioner acquired in 1918, when he acquired his lands. They are incidents of ownership.

Respectfully submitted,

GEORGE G. WITTER,

Attorney for Petitioner.